

Without specific information about these types of assumptions, it is not possible to identify how much of the remaining differences in revenue estimates between the Administration's budget and the CBO reestimates are due to each assumption. In this discussion, the reestimates attributable to specific assumptions are identified.

CBO's revenue reestimates based on technical estimating differences account for \$29.5 billion of the estimated potential revenue shortfall over the 1982-1985 period, or almost 90 percent of the total. The revenue reestimates based on technical factors discussed here are divided into two types:

- o Those resulting from the estimation of the revenue effects of some of the provisions of the recently enacted Economic Recovery Tax Act of 1981 (ERTA), and
- o Those resulting from other technical procedures and assumptions.

Technical reestimates of ERTA provisions mostly affect individual and corporate income taxes. Other technical differences arise from varying assumptions about the timing of tax payments and taxpayer behavior other than that related to ERTA and, to a lesser degree, from differences in estimating procedures. Although these other differences affect all types of taxes, they account for most of the technical differences in the reestimates of the nonincome taxes. This section first discusses the reestimates related to ERTA and then analyzes the reestimates from other technical factors. Total CBO technical differences from both ERTA and other factors are summarized in Table 21.

Economic Recovery Tax Act

Estimates of the revenue effects of the Economic Recovery Tax Act require assumptions about the distribution of income and investment and about the economic and taxpaying behavior of affected individuals. In this analysis, revenue reestimates attributable to such assumptions are classified as technical reestimates.

Other reestimates of the revenue effects of ERTA are directly attributable to the differences in economic assumptions that are discussed above. Table 22 summarizes the CBO revenue reestimates based on the effects of ERTA, distinguishing between those attributable to technical estimating differences and those attributable to economic assumptions.

TABLE 21. CBO REVENUE REESTIMATES, BY SOURCE, BASED ON CBO TECHNICAL ESTIMATING DIFFERENCES (By fiscal year, in billions of dollars)

	1982	1983	1984	1985
Individual Income Taxes	4.8	6.7	-4.9	-8.1
Corporate Income Taxes	1.1	-10.7	-7.9	-9.1
Social Insurance Taxes	0.2	0.1	0.1	0.4
Excise Taxes (including Windfall Profit Taxes)	-0.6	0.2	0.3	1.0
Federal Reserve Payments	-1.2	-1.5	-0.6	0.2
Other	<u>a/</u>	<u>a/</u>	<u>a/</u>	<u>a/</u>
Total	4.3	-5.2	-13.0	-15.6

a/ Less than \$50 million.

CBO's estimates of revenue reductions attributable to ERTA are larger in each year than are the Administration's. Relative to prior law, CBO's estimates range from a revenue reduction of \$39.0 billion in 1982 to \$189.2 billion in 1985. The Administration's estimates range from a reduction of \$38.3 billion in 1982 to \$176.7 billion in 1985.

CBO's reestimates of the revenue effects of ERTA that are attributable to technical factors lower CBO's revenue projections below the Administration's by growing amounts each year, from \$1.4 billion in 1982 to \$12.1 billion in 1985. The largest technical estimating differences occur in the provisions for across-the-board reductions in individual income tax rates; the indexing of individual income tax brackets, zero bracket amounts, and personal exemption; and the Accelerated Cost Recovery System (ACRS).

Technical differences in the estimation of the across-the-board rate reductions are most significant in 1984 when the CBO estimate of individual income taxes is over \$5 billion below the Administration's estimate. This differential narrows to about \$3 billion in 1985. The technical estimating differences for the indexing provisions, which go into effect in 1985, lower

TABLE 22. REVENUE REESTIMATES BASED ON THE EFFECTS OF ECONOMIC RECOVERY TAX ACT (By fiscal year, in billions of dollars)

	1982	1983	1984	1985
Differences from Technical Factors				
Rate cuts	-0.4	-0.7	-5.2	-3.2
Indexing	---	---	---	-3.4
Accelerated Cost Recovery System				
Individual	a/	-0.3	-0.2	-0.3
Corporate	-0.9	-3.3	-3.1	-4.1
Other	a/	-0.8	-1.1	-1.1
Subtotal, Technical Differences	-1.4	-5.1	-9.6	-12.1
Differences from Economic Assumptions (CBO Baseline)				
Rate cuts	0.3	1.1	-0.2	1.0
Indexing	---	---	---	-3.8
Accelerated Cost Recovery System				
Individual	0.1	0.2	0.3	0.5
Corporate	0.2	0.6	1.3	2.5
Other	a/	-0.1	-0.4	-0.6
Subtotal, Economic Differences	0.6	1.7	0.9	-0.4
Total	-0.7	-3.4	-8.6	-12.5

a/ Less than \$50 million.

the CBO estimate of individual income taxes by another \$3 billion below the Administration's estimate for that year. For the effects of ACRS on individual income taxes, these differences reduce the CBO revenue estimates below the Administration's estimates by \$0.3 billion or less each year. Net technical differences attributable to all of the other individual income tax provisions of ERTA raise the CBO revenue estimates above the Administration's by about \$1 billion or less in each year. The total net effect of the technical estimating differences for ERTA raises CBO's reestimates of individual income taxes above those of the Administration by about \$0.4 billion in 1982, and \$0.1 billion in 1983, and lowers the reestimates below those of the Administration by about \$4.3 billion in 1984 and \$6.6 billion in 1985.

For corporate income taxes, technical factors related to the estimation of the revenue effects of ERTA reduce CBO estimates below the Administration's by about \$1 billion in 1982 and by slightly more than \$5 billion annually from 1983 to 1985. Almost 70 percent of these differences are attributable to estimates of the accelerated cost recovery provisions of the act. In 1985, the total technical reestimates of ERTA's effects on corporate taxes are equivalent to fully 8 percent of CBO's estimate of total corporate income taxes under current law.

Other Technical Estimating Differences

Net technical differences from CBO assumptions about the timing of tax payments and other taxpayer behavior, unrelated to ERTA, are quite small, less than 1 percent of revenues annually from 1982 to 1985. These considerations combine to raise CBO's revenue reestimates above the Administration's by \$5.7 billion in 1982 and to lower them by growing amounts thereafter, from \$0.1 billion less in 1983 to \$3.5 billion less in 1985.

For income taxes, these differences are partly attributable to assumptions about the timing of tax collections. For example, based on receipts for the first quarter of fiscal year 1982, CBO has assumed a large overpayment of corporate income taxes this year compared to liabilities. This overpayment may have been caused, in part, by uncertainty about the effects of recent requirements for the prompt payment of taxes and of other recent tax changes. CBO also assumes that more than half of the 1982 overpayments will be offset by refunds in 1983, which would cause corporate taxes to be smaller than liabilities in that year. The Administration also may have assumed a longer time lag between changes in corporate tax liability and related adjustments in payments during the 1983-1985 period.

The net effect of these technical estimating differences unrelated to ERTA raise the CBO estimates of corporate income taxes above those of the Administration in 1982 by about \$2 billion. For 1983 through 1985, these factors reduce the CBO estimates of corporate income taxes below the Administration's by between about \$3 billion to \$5 billion annually. Such technical factors as the timing of tax payments and the distribution of income across tax brackets raise the CBO estimates of individual income taxes above the Administration's by over \$4 billion in 1982 and over \$6 billion in 1983, and reduce the CBO estimates by small amounts in 1984 and 1985.

CBO's technical reestimates raise the estimates of social insurance taxes by amounts ranging from \$0.1 billion to \$0.4 billion per year because of CBO's inclusion of federal employee pay raises beyond 1982, which raises federal employee retirement taxes, and because of increased health insurance refunds resulting from a recent court decision, which are included in the Administration's estimates but not in CBO's.

CBO's reestimates of windfall profit taxes tend to be higher than the Administration's, in part, because of technical differences in assumptions about the rate at which domestic oil may be reclassified as incremental tertiary oil for purposes of the tax. CBO assumes a slower rate of reclassification of oil as tertiary oil, which is taxed at a lower rate. These assumption differences raise CBO windfall profit tax estimates above the Administration by about \$0.6 billion in 1983, \$0.9 billion in 1984, and \$1.4 billion in 1985. Differences in technical estimation methods lower CBO net reestimates of excise taxes, other than windfall profit taxes, below those of the Administration by amounts ranging from \$0.3 billion to \$0.6 billion per year.

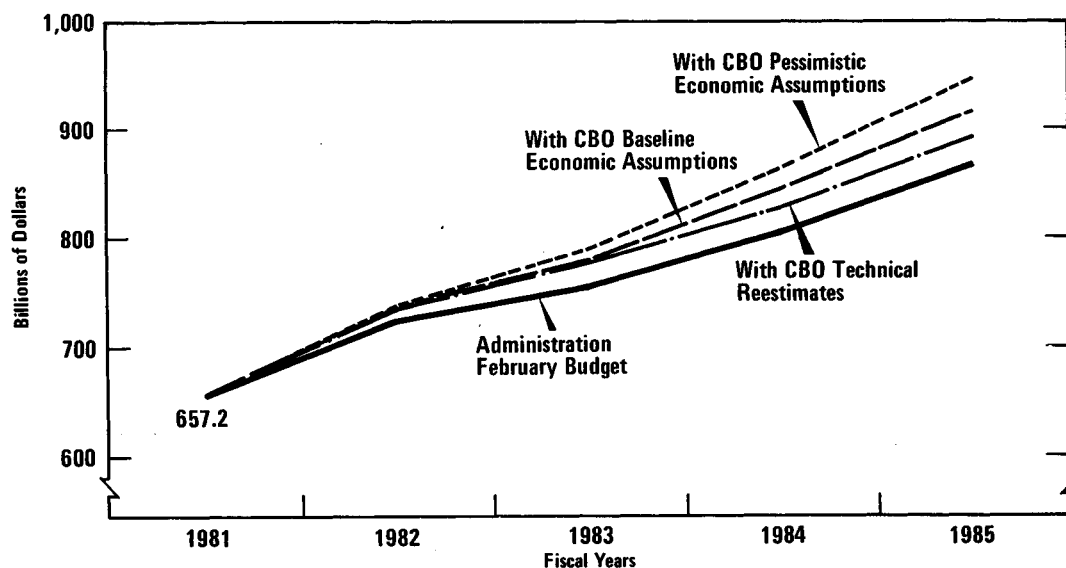
All remaining significant technical estimating differences are attributable to different methods used to estimate Federal Reserve payments. CBO identifies as differences due to economic assumptions only those differences estimated to result from different levels of interest rates. Therefore, technical differences include differences because of other assumptions, which might be considered economic or partially economic, but which cannot be estimated without information about the Administration's assumptions. These include assumptions about the extent to which the Federal Reserve's portfolio management will keep earnings high by retaining medium and long-term securities acquired at peak interest rates. Such differences cause CBO estimates to be lower than the Administration's by \$1.2 billion in 1982, \$1.5 billion in 1983, \$0.6 billion in 1984, and higher than the Administration by \$0.2 billion in 1985.

CHAPTER IV. CBO OUTLAY REESTIMATES

The Congressional Budget Office's analysis of the President's February budget spending estimates suggests that unified budget outlays could be much higher than the Administration projects, by amounts ranging from at least \$13 billion in 1982 to \$47 billion or more in 1985.

One reason why outlays may be higher than the Administration projects is that its budget estimates seem to understate probable expenditures. CBO has made a technical analysis of the Administration's estimates. The preliminary results of this analysis suggest that outlays may have been underestimated by about \$12 billion in 1982 and by over \$20 billion in each of the next three years (see Figure 10). For the entire 1982-1985 period, CBO's technical reestimates would add more than \$75 billion to the Administration's projections of outlays.

Figure 10.
CBO Outlay Reestimates



A second reason why outlays could be higher is that the economy may fail to perform as the Administration assumes it will. Under CBO's baseline economic forecast and longer-run assumptions, total outlays over the 1982-1985 period would be higher by about \$45 billion--\$1 billion in 1982, \$3 billion in 1983, over \$16 billion in 1984, and \$24 billion in 1985. The adjustments to the Administration's estimates resulting from the use of CBO's baseline economic assumptions are not as large as those resulting from the technical reestimates in any year except 1985. Under CBO's alternative set of pessimistic economic assumptions, however, outlays could be higher than projected by the Administration by at least \$12 billion in 1983, \$35 billion in 1984, and more than \$55 billion in 1985.

A third reason for higher outlays in 1983-1985 is that the Administration may not be successful in meeting all of its savings targets for various management initiatives, such as improved debt collection procedures and disposal of surplus federal property. CBO has not been able to develop its own independent estimates of the results of such initiatives, but believes many of the Administration's estimates to be very optimistic.

Finally, the Administration is proposing significant spending reductions that require legislative action, especially for entitlement programs. The Congress may not approve all of these proposals. Also, the Administration has projected savings from a major reform of health care financing that has not yet been developed and is already greatly delayed.

This chapter provides CBO's reestimates of the President's budget proposals, showing the outlay differences that could result from the first two reasons. The reestimates are divided into two categories: (1) those that result from substituting CBO's economic assumptions for the Administration's, and (2) those that result from using CBO's technical estimating methods and from other factors. The reestimates using CBO baseline economic assumptions and technical estimating methods are summarized in Table 23. They assume that all of the President's legislative proposals are approved by the Congress and that the Administration is successful in meeting most of its targets for savings from management initiatives--in short, they make no adjustments based upon the third and fourth reasons given above.

The next two sections of the chapter discuss the two categories of differences involved in the outlay reestimates. A third section provides a brief discussion of the various Administration budget estimates that CBO was unable to evaluate because of lack of specific supporting documentation or other details. This includes over \$7 billion of savings to be achieved in 1985 from planned management initiatives. The remainder of the chapter details the CBO outlay reestimates for each major function of the budget.

TABLE 23. CBO REESTIMATES OF THE ADMINISTRATION'S SPENDING PROPOSALS (By fiscal year, in billions of dollars)

	1982	1983	1984	1985
President's February Budget	725.3	757.6	805.9	868.5
Preliminary CBO Reestimates				
Different economic assumptions	1.2	3.2	16.4	24.2
Technical reestimates	12.2	19.9	22.1	23.0
Total Reestimates	13.5	23.1	38.5	47.2
President's Budget Reestimated	738.8	780.7	844.5	915.7

DIFFERENCES IN ECONOMIC ASSUMPTIONS

Economic conditions have major effects on federal budget outlays. About 30 percent of federal spending is directly indexed for inflation through automatic cost-of-living adjustments (COLAs). Social Security is the largest indexed program, accounting for 21 percent of total outlays in 1981. Other directly indexed programs include retirement benefits for federal civilian and military employees, veterans' pensions, railroad retirement benefits, and Supplemental Security Income benefits. Medicare and Medicaid costs, while not directly indexed for inflation, increase over time with the rising costs of medical care. The costs of certain other benefit programs, such as unemployment insurance and food stamps, vary with changes in the level of unemployment in the economy. Finally, the cost of servicing the federal debt depends on the level of interest rates. In sum, the economic variables having the largest effects on federal outlays are prices, unemployment, and interest rates.

The Congressional Budget Office recently published its baseline economic forecast for calendar years 1982-1983, together with longer-run economic assumptions for 1984-1987. ^{1/} The Administration's assumptions, which are explained in the President's February budget, are briefly discussed in Chapter II of this report. The following paragraphs describe the differences in these assumptions for the three variables that affect spending estimates--prices, unemployment, and interest rates.

^{1/} See Congressional Budget Office, The Prospects for Economic Recovery (February 1982).

Prices

Both the Administration and CBO project a further slowing of inflation over the next several years. The projected patterns of price increases differ somewhat, however, and CBO projects a more gradual decline in the rate of inflation than does the Administration. Federal outlays are particularly sensitive to annual COLAs for Social Security and other indexed benefit programs.

The Administration and CBO have identical assumptions for the 1982 and 1983 cost-of-living adjustments for Social Security benefits, but CBO is projecting COLAs for 1984 and 1985 that are about two percentage points higher than assumed for the Administration's budget estimates.

Annual Social Security COLAs (Percent)

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
Administration	8.1	6.5	4.8	4.8
CBO	8.1	6.5	7.2	6.5

The Social Security COLA adjustments that are made in July of each year are based on the percentage increase in the Consumer Price Index for urban wage earners and clerical employees (CPI-W), measured from the first quarter of the preceding year to the first quarter of the current year.

In CBO's baseline projections, it is assumed that the Social Security COLAs will diminish in 1982 and 1983, increase again in 1984, and then resume their downward trend. The explanation for this pattern lies in developments in the CPI-W assumed by CBO for preceding calendar years.

- o World oil prices are assumed to remain constant through the end of 1982, and then to increase at about the overall U.S. rate of inflation thereafter. Oil prices constitute about one-seventh of the CPI-W, either directly or through their impact on the costs of production of other goods and services.
- o Mortgage interest rates are expected to decline through 1982, and then to stabilize in 1983. CBO assumes that house prices will rise enough in 1982 to offset this reduction in mortgage interest costs. Since homeownership costs have a weight of about one-quarter in the CPI-W, movements in interest rates and house prices can affect COLAs substantially.

Both of these factors tend to hold down the growth of the CPI-W in calendar year 1982 but not in 1983. Consequently, the Social Security COLA of July 1984 is projected to exceed that of July 1983. Nevertheless, the underlying rate of inflation, which is driven primarily by wage costs, is expected to be on a steadily declining trend throughout the projection period; therefore, with no further special factors operating, the COLA adjustments should resume their downward movement after 1984.

Unemployment and Interest Rates

For unemployment and interest rates, the Administration forecast and the CBO baseline forecast for 1982 are quite similar. The forecasts and assumptions also show similar patterns for 1983-1985--a declining unemployment rate, and falling interest rates (after 1983 in the case of the CBO assumptions). For each variable, however, CBO projects a more gradual change than does the Administration. As a result, these two variables are somewhat higher in the CBO baseline assumptions for 1983-1985 than in the Administration's assumptions.

The difference in the unemployment rate assumptions is largest in 1985. The Administration's budget estimates assume an unemployment rate of 6.4 percent in that year, whereas the CBO baseline assumptions project an unemployment rate of 7.2 percent. For 91-day Treasury bill rates, the differences range from 2.7 percentage points in calendar year 1983 to 1.8 percentage points in 1984 and 0.9 percentage points in 1985.

CBO Baseline Assumptions

The implications for budget outlays of the differences in the Administration and CBO baseline economic assumptions are shown in Table 24. Use of the CBO economic assumptions has little effect on outlays the first two years, adding only \$1.2 billion in 1982 and \$3.2 billion in 1983--mostly as a result of higher interest rates projected by CBO.

For 1984 and 1985, the outlay impact of CBO's baseline assumptions is much larger. Projected outlays in 1984 are raised by over \$16 billion and in 1985 by \$24 billion. The largest increases again are for interest costs. The higher interest rates projected by CBO add approximately \$10 billion to outlays in 1984 and \$7 billion to outlays in 1985. The higher budget deficits resulting from the application of CBO's economic assumptions to the Administration's budget estimates add another \$2.5 billion in interest costs in 1984 and almost \$5 billion in 1985.

TABLE 24. OUTLAY REESTIMATES BASED ON CBO'S BASELINE ECONOMIC ASSUMPTIONS (By fiscal year, in billions of dollars)

	1982	1983	1984	1985
Interest Costs				
Higher interest rates	0.9	1.4	9.8	6.6
Higher budget deficits	0.3	0.9	2.5	4.7
Social Security and Other Benefits Indexed to the CPI	---	a/	1.4	6.8
Other Benefits Affected by Inflation	---	0.1	0.9	2.2
Unemployment Compensation and Related Benefits	---	<u>0.9</u>	<u>1.7</u>	<u>4.0</u>
Total	1.2	3.2	16.4	24.2

a/ Less than \$50 million.

The higher COLAs projected by CBO in 1984 and 1985 for Social Security and other indexed benefits add about \$1 billion to 1984 outlays and close to \$7 billion to 1985 outlays. The impact of the higher COLAs for 1984 is not fully felt until 1985. Other benefits affected by inflation--largely Medicare and Medicaid--also show somewhat higher outlays under CBO economic assumptions than projected by the Administration. The increase is relatively small in 1983 and 1984, but reaches nearly \$2 billion by 1985.

The more slowly declining unemployment rate in CBO's baseline economic assumptions would raise projected federal outlays by approximately \$1 billion in 1983, \$2 billion in 1984, and over \$4 billion in 1985. The bulk of these increased outlays is for unemployment insurance benefits. Outlays for food stamps, Aid to Families with Dependent Children (AFDC), and Medicaid are also somewhat higher.

Pessimistic Alternative

In developing its baseline economic assumptions, CBO prepared two sets of alternative assumptions--one more optimistic than the baseline assumption, the other more pessimistic. The Administration's economic assumptions are similar to the optimistic alternative. The pessimistic alternative takes account of the potential risks to the economy of a tight monetary policy combined with a stimulative fiscal policy. In this latter economic scenario, the three variables of inflation, unemployment, and interest rates are uniformly higher than in the CBO baseline assumptions (see Chapter II). If the economy were to follow the path of the CBO pessimistic alternative, outlays under the President's budgetary proposals would be much higher than estimated by the Administration, particularly in 1984 and 1985. As shown in Table 25, this alternative adds \$12 billion to outlays in 1983, \$36 billion in 1984, and \$57 billion in 1985. For the entire 1982-1985 period, total outlays would be higher than the Administration's by over \$100 billion.

TABLE 25. OUTLAY REESTIMATES BASED ON CBO'S PESSIMISTIC ECONOMIC ASSUMPTIONS (By fiscal year, in billions of dollars)

	1982	1983	1984	1985
Interest Costs				
Higher interest rates	1.5	6.9	19.1	19.1
Higher budget deficits	0.4	2.1	6.1	12.3
Social Security and Other Benefits Indexed to the CPI	---	0.2	3.0	11.5
Other Benefits Affected by Inflation	---	0.2	1.8	3.8
Unemployment Compensation and Related Benefits	---	<u>2.9</u>	<u>5.9</u>	<u>10.2</u>
Total	1.9	12.3	36.0	56.8

The CBO pessimistic assumptions demonstrate how sensitive the federal budget has become to interest rates. Higher interest rates would add \$47 billion to federal outlays over the 1982-1985 period, accounting for almost one-half of the total increase under the pessimistic alternative. The remaining \$60 billion of the increase can be attributed in roughly equal shares to higher inflation, higher unemployment, and higher budget deficits.

TECHNICAL ESTIMATING DIFFERENCES

Technical estimating differences between the Administration and CBO arise from the use of different assumptions about how quickly appropriated funds will be disbursed, from different programmatic assumptions, and from other factors. For 1982-1985, these technical estimating differences are quite large. The use of CBO estimating methods and programmatic assumptions increases the Administration's outlay estimates by about 2 percent in each year, beginning with about \$12 billion in 1982 and averaging over \$20 billion for each of the next three years. Over the entire period, these technical differences add more than \$75 billion to total outlays. The major CBO technical reestimates are for defense procurement activities, farm price supports, net interest costs, and offsetting receipts from leasing Outer Continental Shelf (OCS) lands, as shown in Table 26.

TABLE 26. CBO TECHNICAL OUTLAY REESTIMATES (By fiscal year, in billions of dollars)

Major Program	1982	1983	1984	1985
Defense Procurement	2.9	1.4	2.6	2.8
Defense Operations	0.5	1.6	-0.3	-0.6
Farm Price Supports	5.1	5.6	2.7	2.4
Medicare	---	0.4	1.0	1.0
Social Security	1.0	0.9	1.2	-0.2
Net Interest	0.9	3.7	8.2	13.5
OCS Offsetting Receipts	0.9	5.2	4.8	3.2
Other (net)	<u>1.0</u>	<u>1.1</u>	<u>2.0</u>	<u>0.9</u>
Total	12.2	19.9	22.1	23.0

The CBO technical reestimates for defense procurement and defense operations result mainly from different assumptions about how quickly

appropriated funds spend out over time. CBO's spending rate assumptions are derived from analyses of historical spending patterns, with particular emphasis on recent spending trends. CBO staff carefully monitor the monthly Treasury statements of actual outlays and consult with defense agency personnel to obtain the latest information on spending patterns. CBO's outlay estimates proved closer to the actual level for fiscal year 1981 than did the Administration's, and spending in the first quarter of 1982 has been consistent with CBO's estimate for the current fiscal year.

The CBO technical reestimate for farm price supports is based on more recent information about the outlook for farm production and commodity prices than was available for the Administration's budget estimates. The outlook has changed dramatically in the last two months, resulting in a substantial increase in the demand for government crop loans. The reestimate also reflects the Administration's voluntary set-aside program for wheat and feed grains, which was announced too late to be included in the February budget estimates.

The technical reestimate for Medicare reflects different assumptions about the utilization of hospital and physician services by the eligible population, hospital costs, and administrative costs of private contractors who process benefit claims. Both the Administration and CBO have underestimated Medicare spending in the past, as costs have continued to increase rapidly.

The CBO technical reestimate for Social Security benefits results mainly from the use of different assumptions about the growth in the number of beneficiaries. CBO staff carefully monitor program data on beneficiary population trends and other cost factors, and base their estimates on the most recent data available. The reestimate for Social Security is less than 1 percent of total program costs--well within the range of estimating error for this program.

The technical reestimate for net interest largely reflects the cost of servicing the higher deficit levels that would result from using CBO's technical reestimates for both revenues and outlays. The increased interest cost resulting from these higher deficits rises from \$2.8 billion in 1983 to \$9.9 billion in 1985.

The technical reestimate for OCS offsetting receipts reflects CBO's preliminary analysis of the Administration's proposed accelerated leasing program for Outer Continental Shelf oil- and gas-bearing lands. Based on actual experience to date with this program, discussions with industry experts, and the outlook for world oil prices, CBO believes that the February budget estimates are overly optimistic about the likely level of

receipts to be derived from the accelerated program. A recent lease sale of Gulf of Mexico offshore lands produced less receipts than CBO expected, and the outlook for 1982 receipts is now much lower than previously estimated. The accelerated program should produce greater receipts, but the prospects for 1983 and beyond are very uncertain at this point.

CBO has also reestimated outlays of off-budget federal entities to take account of projected higher loan asset sales to the Federal Financing Bank (FFB). This technical reestimate adds over \$500 million to projected FFB net outlays in 1982, almost \$800 million in 1983, over \$900 million in 1984, and more than \$1 billion in 1985.

UNEVALUATED ADMINISTRATION SAVINGS ESTIMATES

The Congressional Budget Office has been unable to evaluate some of the Administration's outlay estimates, mainly because of a lack of information. Estimated savings from several proposed management initiatives, for example, cannot be evaluated until they have been carried out. These include the prevention of waste, fraud, and abuse in unspecified programs; improved debt collection; and the sale of surplus federal property. The Administration projects savings from these initiatives at \$7.0 billion by 1985, a target that appears optimistic in light of past experience.

Spending estimates sometimes reflect estimating biases, which may be either upward or downward depending upon the kinds of policies being advocated. For example, all administrations tend to overestimate outlays for new programs. The Administration's outlay estimates for the new hazardous substance response trust fund are a case in point (see Function 300 reestimates). On the other hand, federal agencies also tend to overestimate the savings to be achieved through administrative or other economies. This would appear to be the case for many of the management initiatives included in the February budget estimates, especially the unallocated targets in Functions 920 (allowances) and 950 (undistributed offsetting receipts). Since no supporting information is available for these initiatives, CBO has not been able to make an independent evaluation.

The President's February budget also includes estimated savings from future legislative proposals not yet developed. For example, savings of nearly \$2 billion in 1984 and over \$4 billion in 1985 are included for health care financing reforms in the Medicare programs. Similar estimates were included in the Administration's budget projections last year, but a specific legislative proposal has not yet been developed. CBO has no basis, therefore, for evaluating the accuracy of these estimates.

Table 27 provides a list of the savings estimates in the President's February budget that CBO was unable to evaluate and, therefore, did not include in its technical reestimates. They are described in more detail in the function-by-function discussion that follows.

TABLE 27. UNEVALUATED ADMINISTRATION SAVINGS ESTIMATES (By fiscal year, in billions of dollars)

Function and Program	1982	1983	1984	1985
Health (550)				
Reform of health care financing (future legislation)	---	---	-2.0	-4.1
Other health care program savings	---	-0.4	-0.4	-0.5
Allowances (920)				
Prevention of fraud, waste, and abuse	-1.0	-1.0	-1.0	-1.0
Undistributed debt collection	---	-1.0	-1.0	-2.0
Undistributed Offsetting Receipts (950)				
Disposition of federal surplus property	<u>---</u>	<u>-1.0</u>	<u>-4.0</u>	<u>-4.0</u>
Total	-1.0	-3.4	-8.4	-11.5

OUTLAY REESTIMATES BY MAJOR FUNCTION

This section provides further details on the CBO technical analysis of the Administration's outlay estimates for fiscal years 1982-1985 for each major functional category of the budget. The reestimates for different economic assumptions were derived by using CBO's baseline assumptions.

FUNCTION 050: NATIONAL DEFENSE

(Outlays in millions of dollars)

	1982	1983	1984	1985
President's February Budget	187,497	221,068	252,969	292,075
Preliminary CBO Reestimates				
Different economic assumptions				
Retired pay	---	-28	168	510
Technical reestimates				
Operations	466	1,583	-306	-635
Procurement	2,950	1,403	2,587	2,753
All other, net	-100	-1,120	-632	-664
Total, Reestimates	3,316	1,838	1,817	1,964
President's Budget Reestimated	190,813	222,906	254,786	294,039

EXPLANATION OF PRELIMINARY CBO REESTIMATES

Different Economic Assumptions

Retired Pay. The costs of military retired pay benefits rise automatically with increases in the Consumer Price Index. The cost-of-living adjustment (COLA) for 1982—8.7 percent—is already known based on actual data through December 1981. CBO and the Administration have similar COLA assumptions for 1983, but CBO projects higher COLAs for 1984 and 1985, as shown below. The use of CBO's COLA assumptions adds \$650 million in outlays over the 1983-1985 period.

Annual Military Retired Pay COLAs (Percent)

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
Administration	8.7	6.6	4.9	4.8
CBO	8.7	6.3	7.2	6.6

Technical Reestimates

The Administration and CBO use comparable methods to estimate defense outlays. Computations for 1982 and 1983 are based on account-level detail, and subsequent years' estimates are based on title-level aggregations consistent with the 1982-1983 analysis. The resulting projections may differ because of factors not easily measured--for example, the outlay impacts of economic conditions and acquisition policies.

The historical spending rates used by both CBO and the Administration actually may understate future spending rates. Factors indicating possible spending rate increases include:

- o Greater use of multiyear procurement;
- o Greater economic production levels;
- o The slowdown in the economy, especially in commercial aviation, prompting more immediate action on defense contracts;
- o Faster progress payments to ease contractors' needs for working capital and to induce earlier deliveries; and
- o Shorter lead times on materials and components used in weapon systems production.

Last year there were large technical estimating differences between the Administration and CBO for defense outlays. Although these differences persist, they have narrowed considerably, largely because the Administration raised its estimates to reflect actual experience. The estimating differences that remain primarily reflect different judgments about the timing of outlays, such as how quickly procurement funds will be disbursed for major weapon systems and when the effect of a large supplemental appropriation bill for operations will appear. Using 1981 estimates as a test case, CBO had a better track record than the Administration for procurement and operations activities. Actual 1981 outlays for each of these activities were within \$0.2 billion of CBO's estimates, but about \$1.0 billion apart from the Administration's estimates.

Operations. CBO estimates that outlays for operations and maintenance (O&M) and for the revolving and management funds will exceed Administration estimates by \$0.5 million in 1982 and \$1.6 million in 1983. CBO estimates for these accounts are derived from historical outlay rates that proved to be very accurate for 1981. For 1982, actual operations outlays for the first four months of the year are consistent with CBO's higher estimate for the entire year.

The CBO estimate for 1983 is based on the same spendout rates used in its analysis for 1981 and 1982. In addition, CBO expects that enactment of the proposed 1982 supplemental will occur late in the year—as was the experience in 1981—causing most of the outlays to occur in 1983. The Administration's estimates, in contrast, assume earlier enactment of the proposed supplemental, with most of the spending occurring in 1982. This difference in assumptions raises CBO's estimate for 1983 outlays about \$358 million over the Administration's (in 1982, it has the opposite effect by \$469 million).

Also, CBO expects that 1983 appropriations to the revolving funds will disburse at the average rate for O&M purchases (about 76 percent in the first year), and that usual revolving fund transactions will net to zero, consistent with general cash management goals. The Administration, on the other hand, outlays revolving fund appropriations at 100 percent, but this higher estimate is more than offset by its lower estimates for other activities not requiring appropriations.

For 1984 and 1985, CBO estimates are lower than the Administration's for reasons that are somewhat harder to discern. The effects of changes in program mix are less evident within operation and maintenance accounts. Most categories of O&M spending appear to increase, but the absence of any clear criteria for separating fast-spending from slow-spending programs prevents decisive outlay analysis. Consequently, CBO uses essentially the same outlay rates for the outyears as for 1981, 1982, and 1983. One possible explanation for the outyear estimating differences is that CBO adjusts the rate downward to reflect a somewhat greater proportion of slower-spending purchases in the outyears and the outlay impact of unused or lapsing budget authority.

Between 1977 and 1980, the Defense Department had average annual lapses of about \$99 million in O&M accounts; in 1981, O&M lapses totaled about \$332 million. Lapses represent funds that were not obligated and therefore will not be spent; they represent a floor for total unexpended funds because some obligations are never liquidated. CBO's outlay rates for O&M accounts assume that about 1 percent of budget authority is never spent; this assumption recognizes an annual phenomenon that would otherwise raise outlays.

Procurement. Procurement outlays have grown in line with in CBO's estimates of March 1981; for the first three months of fiscal year 1982, they